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To: Employment Advisory Council

From: Bill Starks, Unemployment Insurance Director

Subject: Voluntary Contribution to limit UI Tax Increases

A 2006 Master Study list (#179) request was filed with the Workforce Services and Community and Economic Development Interim Committee "to study options to limit the amount of an employer's Unemployment Insurance Tax rate increase and estimating the potential impact on the Unemployment Insurance Trust Fund." The following is a brief background on what stimulated this study item, a possible solution, and the estimated cost to implement this potential provision. It will be presented to the Advisory Council on August 24th and to Interim in September for possible legislative adoption in the 2007 legislative general session.

Background: State Representative Merlynn Newbold inquired whether our Unemployment Insurance (UI) contribution statutes might be amended to provide some tax relief to an employer that had experienced a significant increase in its contribution rate in 2005. While the specifics of Representative Newbold's constituent are unknown, a small number of employers may find themselves in a similar scenario as follows: An employer has UI benefit costs charged against its account, which subsequently triggers a large spike in the UI contribution rate the following year. The employer's taxable payroll then increases dramatically in subsequent years. The employer may end up paying substantially more (up to 3-4 times more) in taxes over the next 3-4 years than the actual amount of benefit charges. The current tax formula was designed to increase an employer's tax rate (over a four-year period) sufficiently to recover approximately the amount of benefits charged to the employer's account, <u>provided the employer's payroll remains fairly similar in size in the year following the benefit charges.</u>

Possible Solution - Voluntary Contributions to Buy down UI Benefit Costs: The only option, which appears viable, that would provide equal protection to all employers and still not have a significant negative impact on the UI Trust Fund is a provision known as a *Voluntary Contribution*. The concept if fairly simple, it provides employers with the option (usually each year, when tax rates are calculated for the subsequent tax year) to buy back benefit costs that have been charged against their UI accounts, thereby reducing their benefit ratio (benefit costs / taxable wages) sufficiently to lower their future contribution rates for up to four years.

Estimated Costs to Implement and maintain: The Department estimates the total one-time cost to implement this provision would be approximately $350,000. Ongoing costs will vary each year depending on how many employers are eligible to participate and how many actually exercise the provision. We estimate the ongoing costs to be approximately $5,000 to $15,000 annually. It should be noted these cost estimates are **unfunded costs**. The Department would require additional funding or would be required to reduce UI program operations in other areas, most likely in UI compliance activities, which would almost certainly have a much larger negative impact on the Trust Fund than the cost of funding this provision. I recommend that if Utah adopts this provision that "Reed Act Funds" are appropriated to cover "start-up" costs associated with implementation and a 10 percent surcharge, in addition to the voluntary contribution be assessed and appropriated back to the Division to help defray some portion of the ongoing costs to administer the provision.

Estimated impact on the UI Trust Fund: The actual impact on the UI Trust Fund can be calculated only after it has been in place for two or more years. It is difficult to forecast the impact, however, it is relatively safe to say that it would likely, over time, have some negative impact simply because an employer would not be likely to make a voluntary contribution unless the expected result in UI tax rate savings exceeded the amount contributed. Initially, we estimate the UI Trust Fund would see a net increase in revenues, as employers buy back benefit charges to reduce their tax rates in future years, however, over the next four years the Fund would see reduced revenues as a result of employers realizing the effect of the lower tax rates. If the percentage of employers who elect to participate is similar to what other states have experienced, the provision should not have a significant impact on the reduction to the UI Trust Fund.

Summary: Should Utah pursue a voluntary contribution provision, we recommend the following guidelines:

- Create 18 distinct employer rate classes, grouped in increments of 0.5 percent
- Limit participation to employers that have experienced an annual rate class increase of at least two to four classes over the previous year.
- Limit the amount of benefit costs that may be bought back to the most recently completed state fiscal year.
- Require that voluntary contributions be received within 30 days of the mailing of the annual rate notice.
- Require participating employers to be in good standing with the Department. The employer's (and predecessor's if applicable) past-due contributions, interest, penalties and costs must be paid in full, and all past-due reports must be filed within 30 days of the mailing of the annual rate notice.
- Assess a 10 percent surcharge (in addition to the voluntary contribution), which is appropriated back to the Department to defray any annual ongoing costs to administer the provision.
- Appropriate "Reed Act Funds" or other one time funds to cover "start-up" costs associated with implementation.